June 6, 2007

Performance and Compensation Committee
California Public Employees' Retirement System
Lincoln Plaza East
400 Q Street
Sacramento, CA 95814

Re: CalPERS Performance Award Program

Dear Members of the Performance and Compensation Committee:

Pension Consulting Alliance, Inc. ("PCA") has been asked to review the performance benchmarks that will be used for purposes of determining the incentive performance bonuses for the senior members of CalPERS Real Estate Staff (i.e. Portfolio Managers, Senior Portfolio Managers and the Senior Investment Officer). In addition, these performance benchmarks will be recommended to be incorporated into the revised performance standards used to evaluate CalPERS real estate portfolio performance. The latter exercise is part of the overall strategic review of CalPERS real estate program.

In creating the performance standards PCA reviewed and established custom benchmarks for each segment of the real estate portfolio based upon the risk levels associated within each particular strategy. Individual risk premia were established and then weighted based upon their anticipated percentage of the real estate portfolio. PCA assumed 25%, 50% and 25% weightings for Core, Value-added and Opportunistic strategies, respectively. For the publicly traded securities within the real estate portfolio, the FTSE EPRA NAREIT Global Real Estate Index will be used as a benchmark. The attached schedule illustrates the actual benchmarks for each strategy within CalPERS' real estate portfolio.

These same performance standards have been incorporated into the proposed Real Estate Staff hurdles for their incentive compensation plan. PCA has learned that the proposed plan will establish a range (100 to 200 basis points over the NCREIF Property Index) and the level of Staff compensation will depend upon where the real estate portfolio performance actually falls. PCA has not been told what the exact percentage of Staff performance compensation will be based upon the real estate portfolio performance. Presumably, a sliding scale will be used.

In sum, PCA concurs with the methodology used to establish the Real Estate Staff performance hurdles for their incentive compensation payments. Should you have any questions, please feel free to contact us.

Very truly yours,

Nori Gerardo Lietz
Managing Director

cc: Russell Read, CalPERS
       Theodore Eliopoulos, CalPERS
       Anne Stausboll, CalPERS
       Al Fernandez, CalPERS
       Pam Alsterlind, Pension Consulting Alliance, Inc.
       Paul Mouchakkaa, Pension Consulting Alliance, Inc.

CalPERS Target Portfolio Return Model

Segment	Base Benchmark	Premium	Total Benchmark
Domestic Core	NCREIF	0.75%	NCREIF+0.0075
International Core	NCREIF	1.25%	NCREIF+0.0125
Opportunistic	NCREIF	4.00%	NCREIF+0.04
Value-Added	NCREIF	2.00%	NCREIF+0.02
International Non-Core	NCREIF	4.00%	NCREIF+0.04
Emerging Market	NCREIF	5.00%	NCREIF+0.05
Housing	NCREIF	4.00%	NCREIF+0.04
CURE	NCREIF	4.00%	NCREIF+0.04
Senior Housing	NCREIF	1.50%	NCREIF+0.015
Natural Resources	NCREIF	0.50%	NCREIF+0.005

Assumed NCREIF Expected Return	8.0%

Target Return by Program

Segment	Target Return
Domestic Core	8.75%
International Core	9.25%
Opportunistic	12.00%
Value-Added	10.00%
International Non-Core	12.00%
Emerging Market	13.00%
Housing	12.00%
CURE	12.00%
Senior Housing	9.50%
Natural Resources	8.50%

CalPERS Target Portfolio Return Model

Detail Breakdown of Core Program

Segment	Target Return	Weighting
Domestic Core	8.8%	50.0%
International Core	9.3%	50.0%
Core Target Return	9.0%	100.0%

Detail Breakdown of Value Added Components of Current Portfolio

Segment	Target Return	Weighting
Value-Added	10.0%	50.0%
Senior Housing	9.5%	25.0%
Natural Resources	8.5%	25.0%
Non-Core Target Return	9.5%	100.0%

Detail Breakdown of Opportunistic Components of Current Portfolio

Segment	Target Return	Weighting
Opportunistic	12.0%	20.0%
International Non-Core	12.0%	25.0%
Emerging Market	13.0%	15.0%
Housing	12.0%	20.0%
CURE	12.0%	20.0%
Non-Core Target Return	12.2%	100.0%

Total Real Estate Portfolio Target Return

Program	Target Return	12/31/06 Weighting
Core	9.0%	25.0%
Value-Added	9.5%	50.0%
Opportunistic	12.2%	25.0%
Total Portfolio	10.0%	100.0%

Bottom Line: Nominal target would be a 200 basis point premium to NPI